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July 21, 2008

Attorneys at Law

***Re: Transfers of Real Property and Legal Entity Interests to LLCs
Assignment No.***

Dear Mr. :

This is in response to your March 17, 2008 letter to Robert Lambert, Acting Assistant Chief Counsel, in which you request a written opinion concerning whether the proposed transfer of real property to a California limited liability corporation (CLLC) and the subsequent transfer of interests in the CLLC to a Delaware limited liability corporation (DLLC) will result in changes in ownership.

As discussed below in detail, we conclude that the proposed transfer of interests in real property to the CLLC would be excluded as transfer of proportional ownership interests under section 62, subdivision (a)(2), and further that the subsequent transfer would be excluded as transfers of ownership interests in legal entities under section 64, subdivision (a). Therefore, the proposed transactions would not be subject to reassessment.

Facts

Mr. D and Mrs. C K ("Client") along with two additional individuals own several parcels of real estate (each piece of property is referred to as a "Parcel," and collectively as "Property") in the City of , County of , California.

Current Ownership of Property:

Client owns fifty percent (50%) joint tenancy ownership interest in the Property. Individual #3 ("#3") and Individual #4 ("#4") own the remaining fifty percent (50%) joint tenancy ownership interest in the Property. Client, #3, and #4 (the "Parties") in the aggregate possess a one hundred percent (100%) ownership interest in the Property.

220.0451.005

Your letter did not specify whether each individual's ownership interest in each Parcel is the same as that held in the Property. We assume that each individual owns the same ownership interest in each Parcel as they do with respect to the Property collectively.

Proposed Transaction #1:

The Parties will organize a CLLC. The Parties will transfer the Property to the CLLC. The Property will be owned by the CLLC. In turn, the CLLC will be owned as follows: D K, C K, #3 and #4 will each own a twenty-five (25%) ownership interest in the CLLC.

Proposed Transaction #2:

After the CLLC and the Property has been transferred to the CLLC, Client will organize a DLLC. D K will assign his twenty-five (25%) ownership interest in the CLLC to the DLLC. C K will assign her twenty-five (25%) ownership interest in the CLLC to the DLLC. The DLLC will be owned as follows: D K's revocable living trust and C K's revocable living trust will each own a fifty (50%) ownership interest in the DLLC.

The following is your Client's understanding of the property tax consequences of Proposed Transactions 1 and 2:

(1) The transfer of the Property to the CLLC would be exempt from reassessment as proportional ownership interest transfers under Section 62, subdivision (a)(2).

(2) Each Client's transfer of their ownership interest in the CLLC to the DLLC is not a transfer of real property but rather a transfer of an interest in a legal entity.

(3) Upon the transfer of the Property to the CLLC, Client, #3 and #4 are considered the "original co-owners" pursuant to section 64, subdivision (d). When the "original co-owners" cumulatively transfer more than fifty percent (50%) of the total ownership interests in CLLC in one or more transactions, the Property that was excluded from reassessment under section 62, subdivision (a)(2), becomes subject to reassessment.

(4) The Client's transfer of their ownership interest in the CLLC to the DLLC does not result in reassessment of the Property; in particular, because each Client's revocable living trust possesses a fifty percent (50%) ownership interest in the DLLC, each Client retains the same ownership percentage in the CLLC (and therefore the underlying Property). In effect, the ultimate ownership of the CLLC (and in turn the Property) is still vested in the "original co-owners" and reassessment is not appropriate.

You have asked us to opine and confirm your Client's understanding, as set forth above.

Law

Article XIII A, section 2 of the California Constitution requires the reassessment of real property upon a "change in ownership." A change in ownership is defined in Revenue and Taxation Code¹ section 60 as "a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest."

Section 62, subdivision (a)(2) provides an exclusion from "change in ownership" for transfers between individuals and a legal entity or between legal entities that result "solely in a change in the method of holding title to the real property and in which proportional ownership interests of the transferors and the transferees..., in each and every piece of real property transferred, remain the same after the transfer." (See also Rule 462.180, subd. (b)(2).)

Section 64, subdivision (a) provides the general rule that the transfer of ownership interests in a legal entity, such as corporate voting stock, does not constitute a transfer of the real property owned by the legal entity, unless the exceptions, as relevant herein, contained in subdivisions (c)(1) or (d) of section 64 apply.

Section 64, subdivision (c)(1), provides that when an individual obtains ownership or control of more than a 50 percent ownership interest in a legal entity, for example, by purchasing more than 50 percent of the voting stock of a corporation, there is a change in ownership of the real property owned by the legal entity in which the controlling interest is obtained ("change in control" rule). (Rev. & Tax. Code, § 64, subd. (c)(1).)

Additionally, section 64, subdivision (d), as interpreted by Rule 462.180, subdivision (b)(2), provides that when a transfer of real property is excluded from change in ownership under section 62, subdivision (a)(2), the person acquiring the legal entity interest immediately after the excluded transfer becomes an "original co-owner" for purposes of determining the change in ownership consequences of any subsequent transfer(s) of that legal entity interest. Subsequently, whenever voting shares or other ownership interests representing cumulatively more than 50 percent of the total interests in the legal entity are transferred by any of the original co-owners in one or more transactions, a change in ownership of that real property owned by the legal entity that was previously excluded from change in ownership reappraisal under section 62, subdivision (a)(2) will be reappraised ("original co-owner" rule). However, when such transfer would also result in a change in ownership under section 64, subdivision (c)(1), the reappraisal of the real property owned by the legal entity is pursuant to section 64, subdivision (c)(1) rather than section 64, subdivision (d).

Rule 462.180, which interprets and clarifies the requirements under section 64 governing the transfer of real property involving legal entities, provides that, for purposes of determining whether more than 50 percent of an entity's total interests have been transferred, certain transfers are not counted or cumulated for purposes of subdivision (d) of section 64. Specifically, subdivision (d)(2) of Rule 462.180 provides that:

¹ All further statutory references are to the Revenue and Taxation Code unless otherwise indicated.

For purposes of this subdivision ((d)(2)), interspousal transfers excluded under Section 63 of the Revenue and Taxation Code, transfers into qualifying trusts excluded under Section 62(d) of the Revenue and Taxation Code, and proportional interest transfers excluded under Section 62(a)(2) of the Revenue and Taxation Code shall not be cumulated or counted to determine a change in ownership.

Original co-owner status terminates when the property excluded from reassessment under section 62, subdivision (a)(2) is reappraised or the property is transferred from the legal entity to the individual(s) who hold interests in that legal entity in a transfer excluded from change in ownership under section 62, subdivision (a)(2). (See Property Tax Annotation 220.0452.)

Legal Analysis

Proposed Transaction #1:

The transfer of Property from each of the Parties to the CLLC is a change in ownership under section 60 unless an exclusion applies. In order to qualify for the exclusion from change in ownership under section 62, subdivision (a)(2), the individuals must have the same ownership interest in *each Parcel* immediately before and immediately after the transfer takes place.

As stated above, your letter does not indicate whether each Parties' ownership interest in *each Parcel* is the same as their ownership interest in the Property collectively, however, we assume this to be the case here. Specifically, we assume that the Client owned fifty percent (50%) joint tenancy ownership interest in each Parcel, with each Client having a twenty-five (25%) percent ownership interest in each Parcel, and #3 and #4 held a fifty percent (50%) joint tenancy ownership interest in each Parcel, with #3 and #4 each owning twenty-five (25%) ownership interest in each Parcel. However, if this is not the case, then our conclusion would be different.

Following the transfer of the Property to the CLLC, each individual will have a twenty-five percent (25%) ownership interest in each Parcel by virtue of their twenty-five percent (25%) ownership interest in the CLLC. For purposes of determining whether a change in ownership has occurred with respect to partnerships or limited liability companies, the law requires consideration of each partner's interest in the entity's capital/equity and profit/loss accounts, rather than their ownership interests in the entity per se. (Rev. & Tax. Code § 64, subd. (e); Rule 462.180, subd. (d)(1); Annotations 220.0385 and 220.0386.) Here, you did not indicate the interest held by each owner of the CLLC in the entity's capital and profits. We therefore assume that each partner had the same interest in the entity's capital and profits as their ownership interest. However, if this is not the case, our answers are likely to be different.

As stated above, we assume that each individual held the same interest in the entity's capital and profits as their ownership interest. Under these assumptions, this transfer would qualify as a proportional ownership interest transfer under section 62, subdivision (a)(2), and would not be subject to reassessment. As you note, all of these individuals become original co-owners with respect to their interests in the CLLC.

Proposed Transaction #2:

In the second transaction, each of your Clients will transfer their twenty-five (25%) interest in the CLLC to the DLLC, of which each Client holds a fifty-percent (50%) ownership interest. Generally, transfers of ownership interests in legal entities (including limited liability company interests, as here) are excluded under section 64, subdivision (a). As stated above, two exceptions to this general rule are the change in control rule under section 64, subdivision (c)(1) and the original co-owner rule under subdivision (d) of section 64.

Here, there is no change in control following the transfer because no individual or entity obtains control of the CLLC. All the Parties involved continue to directly or indirectly hold a twenty-five percent (25%) interest in the CLLC (which we assume to mean that each individual has a 25% interest in the entity's capital and profits), and DLLC obtains fifty-percent (50%) interest in CLLC.

Furthermore, because Transaction #1 is excluded as a section 62, subdivision (a)(2) proportional interest transfer, each Client, #3 and #4 are original co-owners. Under the proposed transaction, a fifty-percent (50%) interest in the CLLC will be transferred by your Client. However, under Rule 462.180, subdivision (d)(2), this transfer is not counted or cumulated for purposes of applying the original co-owner rule because proportional transfers excluded under section 62, subdivision (a)(2) are not cumulated or counted to determine a change in ownership. Here, more than 50 percent of the total interests in the CLLC are not being transferred by any of the original co-owners; therefore, the original co-owner rule does not apply. Thus, a change in ownership does not result under this Proposed Transaction #2 pursuant to section 64, subdivision (a).

The views expressed in this letter are only advisory in nature. They represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Sincerely,

/s/ Kiren Kaur Chohan

Kiren Kaur Chohan
Tax Counsel III

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cc:

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